

Message Text

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TO AMEMBASSY COPENHAGEN IMMEDIATE
INFO ALL NATO CAPITALS PRIORITY
USLOSACLANT NORFOLK PRIORITY
USNMRSHPA BELGIUM PRIORITY

C O N F I D E N T I A L STATE 218807

E.O. 11652: GDS

TAGS: MPOL, NATO, DA

SUBJECT: NATO ARMS COOPERATION AND DEP SECDEF MEMORANDUM
ON COPRODUCTION AND OFFSET

REFS: (A) COPENHAGEN 5079 (DTG 071539 AUG 78)
-- (B) STATE 203087 (DTG 102251Z AUG 78)
-- (C) COPENHAGEN 5337 (DTG 181157Z AUG 78)

1. THE PURPOSE OF THIS MESSAGE IS TO CLARIFY DOD'S
POLICY ON COMPENSATORY COPRODUCTION AND OFFSET ARRANGE-
MENTS AS STATED IN DEPSECDEF MEMO OF 4 MAY 1978 (QUOTED
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IN PARA 8). YOU SHOULD DRAW ON THE FOLLOWING TO
CLARIFY US POLICY, IN YOUR DISCUSSIONS WITH RADM RODHOLM
AND OTHER OFFICIALS, AS YOU DEEM APPROPRIATE.

2. THE DEPSECDEF MEMO IS CONCERNED WITH AGREEMENTS
WHICH INVOLVE UNDERTAKINGS BY DOD TO PROCURE FOREIGN
PRODUCTS IN EXCHANGE FOR FOREIGN PROCUREMENTS FROM
THE US. BECAUSE GOVERNMENTAL RESOURCES ARE OFTEN
NECESSARY TO ASSURE PERFORMANCE IN MAJOR INTERNATIONAL
PROGRAMS,OR BECAUSE US FIRMS MAY NOT BE ABLE TO PROVIDE

SUFFICIENT COMPENSATION AS PART OF AN ECONOMICALLY EFFICIENT TRANSACTION, GOVERNMENTAL UNDERWRITING MAY BE REQUIRED. IF DOD DOES OBLIGATE ITSELF TO MAKE

COMPENSATORY PURCHASES, OR TO ASSURE WHAT WOULD OTHERWISE BE INEFFICIENT COPRODUCTION OFFERS, IT MAY HAVE TO PAY A COST PENALTY FOR DOING SO. THE COST MAY INCLUDE NOT ONLY A HIGHER PRICE PAID FOR SUCH PURCHASES OR COPRODUCTION, BUT ALSO THE POLITICAL COST OF DIVERTING BUSINESS AWAY FROM US FIRMS, AND POSSIBLE FRICTION WITH OTHER COUNTRIES IF SPECIFIED OFFSET GOALS ARE NOT MET. ON THE OTHER HAND, BENEFITS TO THE US MIGHT INCLUDE AN OVERALL NET INCREASE IN US SALES AND EMPLOYMENT AND, IN THE CASE OF ALLIES, INCREASED ALLIANCE MILITARY EFFECTIVENESS.

3. THE INTENT OF THE MEMORANDUM IS NOT TO STOP ALL COMPENSATORY COPRODUCTION OR OFFSET ACTIVITIES BETWEEN THE UNITED STATES AND OTHER GOVERNMENTS. FIRST, IT DEALS ONLY WITH SUCH ARRANGEMENTS WHEREBY DOD BECOMES A PARTY AND THEREBY BECOMES OBLIGATED TO FULFILL THE TERMS OF THE OFFSET AGREEMENT. IT IS NOT AIMED AT ARRANGEMENTS BETWEEN US INDUSTRY AND CONFIDENTIAL

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FOREIGN GOVERNMENTS AND INDUSTRIES. SECOND, ALTHOUGH THE MEMORANDUM STATES THE DOD PREFERENCE NOT TO BECOME A PARTY, IT PROVIDES FOR EXCEPTIONS, WHICH MEANS THAT JUDGMENTS MUST BE MADE ON A CASE BY CASE BASIS. IN THIS CONNECTION, WE ANTICIPATE -- AS THE THIRD PARAGRAPH INDICATES -- THAT MOST EXCEPTIONS WILL RELATE TO ARRANGEMENTS WITH NATO, AND WITH INDIVIDUAL NATO ALLIES. IMPROVED COOPERATION IN DEFENSE PROGRAMS AND BETTER STANDARDIZATION AND INTEROPERABILITY IN NATO CAN DIRECTLY CONTRIBUTE TO INCREASED MILITARY EFFECTIVENESS IN THE ALLIANCE. ON THIS BASIS, AN EXCEPTION TO POLICY MAY BE JUSTIFIED. FURTHER, IT SHOULD BE NOTED THAT OSD INITIATED THE MEMORANDUM AND RETAINS ALL REQUISITE AUTHORITY FOR INTERPRETATION OF ITS PROVISIONS.

4. THE F-16 ARRANGEMENT IS BASICALLY AN EXAMPLE OF A COMPENSATORY COPRODUCTION ARRANGEMENT; THE USG COMMITTED ITSELF TO SEEK A 100 PERCENT COMPENSATORY COPRODUCTION BY THE FOUR EUROPEAN NATIONS.

HOWEVER, UNDER CURRENT POLICY AN EXCEPTION, AS PROVIDED IN THE DUNCAN MEMORANDUM, WOULD HAVE TO BE GRANTED FOR THE F-16 PROGRAM, GIVEN THE IMPORTANCE THE USG PLACES ON THIS PROGRAM IN TERMS OF ITS CONTRIBUTION TO IMPROVED MILITARY EFFECTIVENESS AND GREATER S/I IN NATO.

5. THE NATO AWACS ARRANGEMENTS ARE CONSISTENT WITH

GUIDELINES GOVERNING EXCEPTIONS TO THE DUNCAN MEMORANDUM SINCE THE UNDERSTANDING OFFERED TO EACH PARTICIPATING ALLY DOES NOT OBLIGATE THE USG TO ASSURE OFFSETS WITHIN OR WITHOUT THE PROGRAM. AN EXCEPTION WOULD BE APPROPRIATE SINCE NATO AWACS PROGRAM IS KEY TO COUNTERING THE SOVIET LOW-LEVEL AIR THREAT, A MAJOR
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STEP FORWARD IN S/I, AND ADDS IMPORTANTLY TO THE COHESIVENESS OF THE ALLIANCE. THEREFORE, DOD WILL WAIVE BUY AMERICAN RESTRICTIONS AND WILL, ALONG WITH CONSIDERATION OF ALLIED SYSTEMS, INTENSIVELY EXAMINE OPPORTUNITIES FOR COST-EFFECTIVE PROCUREMENT FROM ALLIES. DOD HAS OFFERED MOUS, REFLECTING THIS INTENTION, WHICH WOULD REMAIN IN EFFECT UNTIL INDIVIDUAL PROCUREMENT SHARES (MINUS BENEFITS FROM THE PROGRAM ITSELF) HAVE BEEN EQUALLED BY DOD PROCUREMENTS.

6. WE ARE ALSO AWARE OF THE GERMAN AND OTHER ALLIED CONCERNS REGARDING THE POLICY STATED IN THE MEMORANDUM. TO DATE THE FRG CONCERN HAS BEEN COMMUNICATED PRIMARILY IN TERMS OF A PARTICULAR COOPERATIVE PROGRAM, THE ANTI-SHIP MISSILE DEFENSE (5 INCH ROLLING AIR FRAME MISSILE). GIVEN THE STRUCTURE OF THIS PROGRAM, THERE DOES NOT APPEAR TO BE A COST EFFECTIVE BASIS FOR COMPENSATORY COPRODUCTION. BUT ANY GENERALIZATION REGARDING THE DOD POLICY TOWARDS COMPENSATORY COPRODUCTION FROM THE EVENTUAL OUTCOME OF US/FRG DISCUSSIONS OF THIS PROGRAM WOULD BE UNWARRANTED BASED UPON THIS OR ANY SINGLE CASE.

7. FYI. THE DUNCAN MEMORANDUM SHOULD NOT BE UNDERSTOOD AS BEING IN ANY WAY INCONSISTENT WITH THE PRESIDENT'S SUPPORT AT THE NATO SUMMIT IN MAY 1977 OF THE "TWO-WAY STREET" CONCEPT IN ARMS COOPERATION, AND FOR A DIALOGUE BETWEEN EUROPE AND NORTH AMERICA ON WAYS TO IMPROVE DEFENSE RESEARCH, DEVELOPMENT, PRODUCTION, AND PROCUREMENT. THIS SPECIFICALLY INCLUDES PURSUING FURTHER DISCUSSIONS WITH THE IEPG IN THESE AREAS. NOR DOES THE MEMORANDUM CON-
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FLICT WITH LEGISLATION SPONSORED BY SENATORS NUNN AND CULVER, WHICH CALLS FOR EMPHASIS UPON COPRODUCTION ARRANGEMENTS IN SUPPORT OF NATO S/I. DOD ACQUISITION PROCEDURES CALL FOR EVALUATION OF COMPLETE LICENSED

PRODUCTION IN EUROPE, OR PARTS OF A SYSTEM IN EUROPE, AS ONE METHOD OF PROMOTING NATO STANDARDIZATION. ALL OF THESE US INITIATIVES SHOULD BE VIEWED IN THE CONTEXT OF THE LARGER GOAL OF INCREASING ALLIANCE MILITARY STRENGTH. AT THE SAME TIME, WHILE COMPENSATORY COPRODUCTION WILL BE CONSIDERED IN THE LIGHT

OF NATO STANDARDIZATION, ALL COOPERATIVE ARRANGEMENTS MUST BE PURSUED WITH COST-EFFECTIVENESS REMAINING A KEY DETERMINANT TO POLICY. END FYI.

8. BEGIN TEXT OF THE DEPSECDEF MEMO OF 4 MAY 1978:

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
UNDER SECRETARY OF DEFENSE FOR RESEARCH AND ENGINEERING
ASSISTANT SECRETARIES OF DEFENSE
GENERAL COUNSEL
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

SUBJECT: GENERAL POLICY ON COMPENSATORY COPRODUCTION
AND OFFSET AGREEMENTS WITH OTHER NATIONS.

THE PURPOSE OF THIS MEMORANDUM IS TO OUTLINE DOD POLICY WITH RESPECT TO COMPENSATORY COPRODUCTION AND OFFSET AGREEMENTS WITH OTHER NATIONS, AND TO DESIGNATE MANAGEMENT RESPONSIBILITIES FOR EVALUATING AND MONITORING THESE AGREEMENTS. MORE DETAILED GUIDANCE IS PROVIDED IN DEPUTY SECRETARY OF DEFENSE MEMORANDUM "GENERAL POLICY ON PURCHASES BY DOD FROM FOREIGN SOURCES IN FURTHERANCE OF GOVERNMENT-TO-GOVERNMENT OFFSET AGREEMENTS," DATED 15 NOVEMBER 1976.

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THE DEMAND FOR COMPENSATORY COPRODUCTION AND OFFSET AGREEMENTS IS BECOMING AN INCREASINGLY COMMON ASPECT OF INTERNATIONAL DEFENSE PROCUREMENT NEGOTIATIONS. SUCH AGREEMENTS OFTEN HAVE THE EFFECT, OR CREATE THE IMPRESSION, OF OBLIGATING THE DOD AND OTHER USG AGENCIES TO PLACE ORDERS FOR SYSTEMS OR COMPONENTS IN FOREIGN COUNTRIES, OR TO REQUIRE US PRIVATE CONTRACTORS TO PLACE ORDERS AND SUBCONTRACTS IN FOREIGN COUNTRIES, AS A CONDITION FOR THE SALE OF US DEFENSE ARTICLES TO THOSE COUNTRIES. THIS HAS LED TO FRICTION BETWEEN ALLIES WHEN SPECIFIED GOALS ARE NOT MET OR EVEN APPROACHED.

BECAUSE OF THE INHERENT DIFFICULTIES IN NEGOTIATING AND IMPLEMENTING COMPENSATORY COPRODUCTION AND OFFSET AGREEMENTS, AND THE ECONOMIC INEFFICIENCIES THEY OFTEN ENTAIL, DOD SHALL NOT NORMALLY ENTER INTO SUCH AGREEMENTS. AN EXCEPTION MAY BE MADE ONLY WHEN

THERE IS NO FEASIBLE ALTERNATIVE TO ENSURE THE SUCCESSFUL COMPLETION OF TRANSACTIONS CONSIDERED TO BE OF SIGNIFICANT IMPORTANCE TO UNITED STATES NATIONAL SECURITY INTERESTS (E.G., RATIONALIZATION OF MUTUAL DEFENSE ARRANGEMENTS).

WHEN COMPENSATORY AGREEMENTS ARE DEEMED NECESSARY, THE FOLLOWING GENERAL GUIDELINES WILL APPLY:

- (1) AGREEMENTS SHOULD BE STRUCTURED AS BROADLY AS POSSIBLE, TO OBTAIN MAXIMUM CREDIT FOR US PURCHASES OF BOTH DEFENSE AND NONDEFENSE GOODS AND SERVICES, REGARDLESS OF TECHNOLOGY CONTENT.

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- (2) SPECIFIC OFFSET TARGETS SHOULD BE AVOIDED, WHETHER STATED IN PERCENTAGE OR MONEY TERMS.
- (3) AGREEMENTS SHOULD BE USED AS VEHICLES FOR REFUSING OR WAIVING ADMINISTRATIVE BARRIERS TO DEFENSE TRADE ERECTED BY ALL PARTIES, E.G., BUY NATIONAL REGULATIONS, PRACTICES AND PROCEDURES.
- (4) FOREIGN FIRMS BIDDING ON CONTRACTS IN ACCORDANCE WITH THE TERMS OF AN OFFSET AGREEMENT MUST ACTIVELY SEEK BIDDING OPPORTUNITIES AND COMPETE ON AN EQUAL BASIS WITH US FIRMS.
- (5) AGREEMENTS INVOLVING SYSTEM SPECIFIC ARRANGEMENTS SHOULD SPECIFY THAT THE BURDEN FOR FULFILLING ANY COMMITMENT RESTS WITH THE US FIRMS DIRECTLY BENEFITING FROM THE SALE.

THE ASSISTANT SECRETARY OF DEFENSE (ISA), IN COORDINATION WITH THE UNDER SECRETARY OF DEFENSE FOR RESEARCH AND ENGINEERING, THE ASSISTANT SECRETARY OF DEFENSE (MRA AND L), OFFICE OF GENERAL COUNSEL, AND DEFENSE SECURITY ASSISTANCE AGENCY, WILL BE RESPONSIBLE FOR REVIEWING ALL PROPOSED COMPENSATORY AGREEMENTS TO WHICH THE DOD WILL BE A PARTY TO DETERMINE IF THE AGREEMENTS COMPLY WITH THE ABOVE PRINCIPLES. THE FINDINGS OF THIS REVIEW WILL BE FORWARDED TO THE DEPUTY SECRETARY OF DEFENSE, WHO HAS AUTHORITY TO APPROVE COMPENSATORY AGREEMENTS WITH OTHER NATIONS FOR THE DOD.

THE UNDER SECRETARY OF DEFENSE FOR RESEARCH AND
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ENGINEERING, IN COORDINATION WITH ISA, MRA AND L,
OGC, DSAA, AND THE MILITARY DEPARTMENTS, WILL BE
RESPONSIBLE FOR PUBLISHING A SEMIANNUAL REPORT

SETTING FORTH THE STATUS OF ALL EXISTING ARE PROPOSED
COMPENSATORY COPRODUCTION AND OFFSET AGREEMENTS.
SUCH REPORTS WILL HIGHLIGHT THE US FINANCIAL OBLIGATION
AND PROVIDE OTHER DETAIL AS REQUIRED.

END TEXT.

CHRISTOPHER

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